

Supreme Court, U.S.  
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78-1582

No. \_\_\_\_\_

IN THE SUPREME COURT  
OF THE UNITED STATES

October Term, 1978

STANLEY G. HARRIS, PETITIONER

v.

TOSHIO INAHARA, ROBERT L.  
KALEZ, LONGVIEW BOOMING CO.,  
ROLAND BRUSCO, ALBERT STARR,  
JAMES A. WOOD, and GOLDEN KEY  
ASSOCIATES, a partnership

PETITION FOR A WRIT OF CERTIORARI  
FROM DECISION OF THE UNITED STATES  
COURT OF APPEALS FOR THE NINTH CIRCUIT

Dennis H. Elliott  
555 Benjamin Franklin Plaza  
Portland, Oregon 97258

Herbert H. Anderson  
800 Pacific Building  
Portland, Oregon 97204

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Petitioners Stanley G. Harris  
prays that a writ of certiorari be  
issued to review the opinion of the  
United States Court of Appeals for the  
Ninth Circuit entered December 7,  
1978, rehearing denied by opinion

entered January 16, 1979.

(a) OPINION BELOW

The opinion of the Court of Appeals has not been officially reported (see Appendix, infra). The petition for a rehearing and request for rehearing in banc was denied by order entered January 16, 1979.

(b) JURISDICTION

(i) The judgment of the Court of Appeals for the Ninth Circuit was entered on December 7, 1978.

(ii) Petitioner's motion for panel rehearing and rehearing in banc was denied by order entered January 16, 1979.

(iii) Jurisdiction of this court is invoked under 28 U.S.C. §1254(1) and 11 U.S.C. §47(c).

(c) QUESTIONS PRESENTED

1. Is the partnership relationship one of "fiduciary capacity" as that term is defined under §17(a)(4) of the Bankruptcy Act, 11 U.S.C. §35(a)(4)? Petitioner Harris filed a petition for bankruptcy and the Respondents herein challenged the dischargeability of the debt owed by Petitioner Harris to them. The bankruptcy court in its opinion held the debt arose out of a partnership relation between Petitioner and Respondents and under the applicable law the partnership relationship was not included in the "fiduciary capacity" language of §17(a)(4) of the Bankruptcy Act. On appeal to the United States District Court for the District of Oregon, the Court held the

"fiduciary capacity" of §17(a)(4) does include the common law partnership arrangement of the Respondents and Petitioner and as a result held the debt owed by Petitioner Harris to Respondents to be non-dischargeable. This was affirmed on appeal by the United States Court of Appeals for the Ninth Circuit.

2. Do the fraud provisions of the Bankruptcy Act require proof of reliance on any misrepresentations by Petitioner, or is it sufficient that a "reasonable man" would have relied under the circumstances? The Respondents herein sought to have Petitioner's debt to them declared non-dischargeable on the basis that it constituted obtaining money by "false pretenses or false representations".

11 U.S.C. §35(a)(2). Respondents had obtained a judgment against Petitioner Harris in the State Court of the State of Oregon. This judgment was affirmed on appeal by the Supreme Court of the State of Oregon. The basis of obtaining the judgment was not proof of a fraudulent misrepresentation. At the trial in the bankruptcy court on the issue of the non-dischargeability of the debt, the Respondents introduced no new evidence, but instead relied on the transcripts of the state court judgment which they did introduce. The bankruptcy court held that no proof of reliance on any misrepresentations had been shown. The United States District Court for the District of Oregon held that actual reliance is not necessary, but

that it was only necessary to determine whether a reasonable man would have relied under the circumstances.

(d) STATUTES INVOLVED

Section 17 of the Bankruptcy Act, codified in 11 U.S.C. §35, provides impertinent part:

"(a) A discharge in bankruptcy shall release a bankrupt from all of his proveable debts, whether allowable in full or in part, except such as ... (2) are liabilities for obtaining money or property by false pretenses or false representations ... (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity..."

(e) STATEMENT OF THE CASE

Petitioner Harris in this case organized a partnership, Golden

Key Associates, comprised of himself and the Respondents to purchase an apartment complex in Portland, Oregon. The apartment complex was subsequently purchased by the partnership from the builder. In the transaction the broker, International Realty, Inc., became entitled to a real estate commission of \$100,000 and an escrow fee of \$2,500. The Petitioner Harris was the president and owner of International Realty.

The Respondents sued Petitioner in the state court for the State of Oregon alleging that the payment to International Realty of the real estate commission and escrow fee constituted a violation of the fiduciary duty owed by Petitioner as a partner of the Respondents. The state

court held that International Realty and Petitioner Harris were liable to account to the partnership for the full amount of the funds appropriated by International Realty as a real estate commission on the transaction. This state court decision was affirmed in Starr v. International Realty Company, Ltd., 271 Or 396, 533 P2d 165 (1975).

Thereafter, Petitioner filed a voluntary petition for bankruptcy with the United States District Court for the District of Oregon. In March of 1975, Respondents herein filed a complaint in the bankruptcy court asking that the debt owed by Petitioner to Respondents arising out of the partnership litigation be

determined non-dischargeable.

At the hearing on Respondent's complaint for non-dischargeability, Respondents presented no new evidence, but instead relied upon the transcript they had compiled in the State Court proceedings. That transcript was introduced as evidence to support Respondents claims of non-dischargeability in the bankruptcy court proceedings. The Respondents claimed that the debt should be held non-dischargeable either because it involved obtaining money by false pretenses or false representations, 11 U.S.C. §35(a)(2) or was a debt created by the Petitioner's fraud, embezzlement, misappropriation or

defalcation was acting in a fiduciary capacity, 11 U.S.C. §35(a)(4).

The state court proceedings involved a suit for an accounting and a request that the commissions received by the Petitioner and his company be held in trust for the benefit of the remaining partners.

The state court case did not involve a determination as to whether the Petitioner's conduct constituted fraud. The Oregon state court, including the Oregon Supreme Court on Appeal, held that Petitioner had an affirmative duty to explain fully the true facts of the transaction to his remaining partners and obtain their "informed consent" to any commissions

to be obtained by Petitioner's company.

The Bankruptcy Court for the District of Oregon held that the Petitioner, the partner of the Respondents, was not acting in a "fiduciary capacity" as that term has been limited in the application of the Bankruptcy Act.

The Bankruptcy Court also held that there was insufficient proof of clear and convincing evidence to show the necessary elements of fraud as contemplated in § 17(a)(2) of the Bankruptcy Act. The Bankruptcy Court opinion noted that there was no proof of reliance by the Respondents, no proof of a false representation, and no proof of fraudulent intent on the part of the Petitioner.

The Respondents then appealed

the decision of the Bankruptcy Court to the United States District Court for the District of Oregon. This appeal to the District Court was taken under the basis of 28 U.S.C. §1334 and 11 U.S.C. §67(c).

The District Court reversed the holding of the Bankruptcy Court and held that Petitioner, acting as a partner of the Respondents, was acting in a "fiduciary capacity" as that term is defined under the Bankruptcy Act. The District Court also held that actual reliance was not a necessary element of proof for Respondents to show obtaining money by false pretenses. The District Court held it was only necessary to determine whether a reasonable man would attach importance to the information in

question, and not whether the Respondents as the actual partners, relied on the "misrepresentation" or concealment. The District Court then held the debt to be non-dischargeable.

Petitioner then appealed to the United States Court of Appeals for the Ninth Circuit. The Ninth Circuit merely held that the opinion of the District Court correctly concluded that the debt was non-dischargeable under the fraud provisions of §17(a)(2) and §17(a)(4) of the Bankruptcy Act. Petitioner's petition for rehearing and request for rehearing in banc was denied by the Ninth Circuit.

(f) REASON FOR ALLOWANCE OF WRIT  
OF CERTIORARI1. Meaning of "Fiduciary  
Capacity".

Since the term "fiduciary capacity" first appeared in the Bankruptcy Act in 1841, it has never been construed to encompass the fiduciary relationship which exists between partners. Every state and federal court and text writer which has addressed the subject has consistently held that the partnership relationship does not come within the "fiduciary capacity" terms of the Bankruptcy Act. 1A Collier on Bankruptcy §17.24(4) (14th Ed 1975); 8 Remington on Bankruptcy §3369, page 259(6) (1965); In Re Frazzetta 1 F Supp 122 (WD NY 1932), Inge v.

Stillwell, 88 Kan 33, 127 P 527 (1912); Gee v. Gee, 84 Minn 384, 87 NW 1116 (1901); Martin v. Starrett, 97 Neb 653, 151 NW 154 (1915); Anno: Bankruptcy-Discharge-Partner, 16 ALR 2d 1151.

The reason for excluding fiduciary relationship such as partnerships from the term "fiduciary capacity" was expressed in Davis v. Aetna Acceptance Co., 293 US 328, 333 (1934):

"The meaning of "fiduciary capacity" has been fixed by judicial construction for very nearly a century. Chapman v. Forsyth, 2 How. 202, 11 L. Ed. 236, decided in 1844, is a decision to the effect that, within the meaning of a like provision of the Act of 1841 ..., a factor does not act in a fiduciary capacity; the statute 'speaks of technical trust, and not those which the law implies from the contract.' ...the

scope of the exception was to be limited accordingly. Through the intervening years that precept has been applied by this court in various situations with unbroken continuity. ... It is not enough, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee *ex maleficio*. He must have been a trustee before the wrong and without reference thereto."

The decisions of the Court of Appeals for the Ninth Circuit and the United States District Court for the District for the District of Oregon on appeal herein ruled that the partnership relationship comes within the "fiduciary capacity" language of the Bankruptcy Act. This Court has not decided whether the partnership relationship comes within the terms of "fiduciary capacity" as that term is used in the Bankruptcy Act. Various state courts and federal district

courts have confronted the questions and each has decided that the partnership relationship does not come within the Bankruptcy Act's definition of "fiduciary capacity". The reasoning for these decisions has been based on this court's decision in Davis v. Aetna Acceptance Co., *supra*, and Chapman v Forsyth, 2 How. 202, 11 L. Ed. 236 (1844).

The decision of the District Court and the Court of Appeals effectively expand the scope of the term "fiduciary capacity" beyond that which was intended by Congress in passing the Act and by this Court as set out in Davis v. Aetna Acceptance Co., *supra*, and preceeding cases.

## 2. Common Law Fraud Proof Required Under Bankruptcy Act.

The decisions of the District

Court and the Court of Appeals herein effectively dispense with the requirement of proof of reliance as an element of non-dischargeability based on obtaining money by false pretenses or fraud. The Ninth Circuit has previously recognized that Section 17(a)(2) of the Bankruptcy Act, 11 U.S.C. §35(a)(2) requires, among other things, the creditor seeking non-dischargeability of a debt must carry his burden of proof that the creditor relied on the misrepresentations. In Re Taylor, 514 F 2d 13 70, 1373 (9th Cir. 1975). This in accord with the recognized interpretations of the fraud provisions of the Act. 1A Collier on Bankruptcy, §17.16, page 1635 and 1636 (14th 1975).

The opinion of the District Court herein, as affirmed by the Court of Appeals for the Ninth Circuit, holds that reliance on the part of the Respondents need not be shown. The District Court held that it was only necessary for the person seeking non-dischargeability to show that a reasonable person would have relied under the circumstances. This reasonable man standard was borrowed by the District Court from the case law surrounding Federal Securities regulations. The District Court utilized the reasonable man standard described in Affiliated Ute Citizens v. United States, 406 US 128, 153-154 (1972) as support for the conclusion that actual reliance was not required under the Bankruptcy Act. Application

of this decision to the Bankruptcy Act is erroneous.

Allowing such a decision to stand will in effect amend the Bankruptcy Act to dispense with the requirement of the proof of reliance as an element of common law fraud. The District Court and the Court of Appeals for the Ninth Circuit in their decisions to hold that actual reliance is not an element to be shown under a request for non-dischargeability under §17(a)(2) of the Act. This is in contravention of established Bankruptcy Act decisions of the Ninth Circuit and involves a misapplication of the "reasonable man" standard set out in Affiliated Ute Citizens v. United States, supra.

#### CONCLUSION

For the reasons set forth above, Petitioner respectfully submits that the writ for certiorari presented herein be granted.

Respectfully Submitted,  
O'CONNELL, GOYAK, HAGEN,  
ELLIOTT & KRAGE, P.C.

By:

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Dennis H. Elliott  
Attorney for Petitioner

APPENDIX

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF OREGON

In Re )  
 )  
STANLEY G. HARRIS, )  
 )  
Bankrupt. ) Bankruptcy  
 ) No. B75-416  
 )  
OPINION  
TOSHIO INAHARA, ROBERT )  
L. KALEZ, LONGVIEW )  
BOOMING CO., ROLAND )  
BRUSCO, ALBERT STARR, )  
JAMES A. WOOD, and )  
GOLDEN KEY ASSOCIATES, )  
a partnership, )  
 )  
Plaintiffs, )  
 )  
vs. )  
 )  
STANLEY G. HARRIS, )  
 )  
Defendant. )  
 )

---

Herbert H. Anderson  
Dezendorf, Spears, Lubersky &  
Campbell  
800 Pacific Building  
Portland, Oregon 97204,

Attorneys for Plaintiffs

Kevin O'Connell, Dennis H.  
 Elliott  
 O'Connell, Goyak, Hagen,  
 Elliott & Krage, P.C.  
 555 Benjamin Franklin Plaza  
 1 S.W. Columbia  
 Portland, Oregon 97258,

Attorneys for  
 Defendant-Bankrupt

**SOLOMON, Judge:**

The plaintiffs appeal from a ruling by the Bankruptcy Judge that the plaintiffs' judgment debt against Stanley Harris, the defendant-bankrupt, for breach of a fiduciary duty was dischargeable in bankruptcy.

Before his adjudication as a bankrupt, Harris was engaged in many businesses. One of them, International Realty, Ltd. (International), specialized in tax-sheltered investments for

high-income taxpayers. Harris was the president and sole stockholder of International.

International organized partnerships to buy real property, primarily apartment and office buildings, to incur paper losses through accelerated depreciation and prepaid interest charges. As a sales tactic, Harris himself frequently invested in those partnerships to show potential investors that he had confidence in the investment. The money that Harris invested generally came from part of the high brokerage fees that he charged on these transactions.

In 1968, Dave Christensen, Inc. (Christensen) offered to sell the

Golden Key Apartments (the apartments) for a net price of \$907,500 - \$207,500 in cash and the assumption of a \$700,000 mortgage.

Haris organized the Golden Key Associates, a partnership, to buy the apartments. Harris was the managing partners. 1/ The other partners are the plaintiffs in this action; most of them are physicians. In December 1968, Harris signed a land sale contract for the partnership to purchase the apartments for \$1,010,000. The contract provided that the partnership would make a \$260,000 down payment as prepaid

interest.

In a separate agreement, which Harris concealed from the plaintiffs, Christensen agreed that International was to receive a broker's commission of \$100,000 and an escrow fee of \$2,500 out of the \$1,010,000 sales price. This left Christensen with a net of \$907,500 for the apartments.2/ Christensen also agreed to convey to International the vendor's interest in the Golden Key land sale contract.

Harris then collected \$260,000 from his partners. He paid \$207,500 to Christensen; this cash payment and the assumption of the \$700,000 mortgage paid Christensen in full for the apartments. Harris paid the other

\$52,500 to International.3/

Harris concealed from his partners, the plaintiffs here, the fact that his company, International, was getting \$102,500 out of the deal and that International was also acquiring Christensen's interest in the land sale contract.

In 1970, when the partnership fell behind in its monthly contract payments, Harris threatened to foreclose the partnership interest in the apartments. The plaintiffs then learned for the first time that International owned the vendor's interest in the contract and that International had received \$102,500 on the sale. The plaintiffs filed a state court action to require Harris to account to the partnership for the

\$102,500 in commissions and to hold the title to the property in trust for them. They prevailed on both grounds.

The Oregon Supreme Court affirmed on the ground that Harris had violated his fiduciary duty to his partners under ORS 68,340(1):4/

When, as in this case, a real estate broker undertakes to join as a member of a partnership or joint venture in the purchase of real property on which he holds a listing, he is also subject to the fiduciary duties of undivided loyalty and complete disclosure owed by one partner to another. Indeed, one of the fundamental duties of any partner who deals on his own account in matters within the scope of his fiduciary relationship is the affirmative duty to make a full disclosure to his partners not only of the fact that he is dealing on his own account, but all of the facts which are material to the transaction...

.....

In this case, Harris did not inform plaintiffs or disclose to them the fact that this property could have

been purchased for \$907,500 "net" to the seller or that upon its purchase for \$1,010,000 Harris or International (of which Harris was the president) would be paid a commission in the amount of \$100,000. In the absence of such a disclosure there could be no effective "consent" by plaintiffs to the payment or retention by Harris of any such "benefit" from that transaction, for the purposes of ORS 68.340(1). Starr v. International Realty, 75 Adv Sh 811, 815-16 (1975).

Harris did not pay the judgment. In February 1975, he filed a voluntary petition in bankruptcy in which he listed debts of more than \$4,800,000, including about \$1,500,000 in unsecured obligations. He also listed his total assets at \$1,231,000 -- his estimate of the value of certain personal property, most of which consisted of art objects. The \$4,800,000 debt figure did not include unpaid federal and state income taxes,

even though Harris acknowledges that he has not filed income tax returns since 1969. Later, when an eight-count indictment was filed against him in federal court, Harris pleaded guilty to one count of "wilfully and knowingly" filing a "false and fraudulent income tax return."

In February 1975, the plaintiffs filed this action in the Bankruptcy Court to declare that their judgment against Harris was not discharged by his bankruptcy.<sup>5/</sup>

The complaint here alleged that the debt was nondischargeable under Section 17(a) of the Bankruptcy Act because it was "created by the bankrupt's fraud and by fraud,

misappropriation or defalcation while acting in a fiduciary capacity."

The plaintiffs submitted the case on the transcript of the state court proceedings and the judgment of the state court. They offered no life testimony. Harris did not offer any evidence.

Later, the plaintiffs moved to amend their complaint to specify the provisions of Section 17(a) on which they relied. The Bankruptcy Judge allowed the plaintiffs to specifically allege Sections 17(a)(2) and (4), but denied their request on Section 17(a)(8). 6/

The Bankruptcy Judge found that the plaintiffs failed to prove fraud under Section 17(a)(2), and he

held that Section 17(a)(4) was inapplicable because Harris was not acting in a fiduciary capacity when the debt was created. The plaintiffs' motion for rehearing was denied, and they appealed from the decision. I reverse.

#### I. Section 17(a)(2)

The plaintiffs contend that Harris's debt to them is nondischargeable under Section 17(a)(2) of the Bankruptcy Act, 11 U.S.C. §35(a)(2), because Harris obtained the money by "false pretenses of false representations" and by "willful and malicious conversion".

To prevail, the plaintiffs must prove fraud. The fraud must be

"positive fraud or fraud in fact, involving moral turpitude or intentional wrong; not implied fraud which may exist without bad faith."

Forsyth v. Vehmeyer, 177 U.S. 177, 182 (1899); Wright v. Lubinko, 515 F.2d 260, 263 (9th Cir. 1975). This requirement of positive fraud is "consonant with equity and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency." (emphasis added) Neal v. Clark, 95 U.S. 704, 709 (1877).

Fraud may consist of concealment or intentional nondisclosure, as well as affirmative misrepresentation, of material facts,

Musgrave et al. v. Lucas et al., 193 Or 401, 410, 238 P.2d 780, 784 (1951), particularly when the parties stand in a confidential or fiduciary relation to one another. Starkweather v. Shaffer, 262 Or 198, 497 P.2d 358, 362 (1972).

The state court in Starr v. International Realty, *supra*, did not make findings on fraud because that action was based on breach of a fiduciary duty, not fraud. The court found that Harris had breached his fiduciary duty to his partners by not disclosing the \$102,500 commission and escrow fee and by obtaining the vendor's interest in the land sale contract without the partners' consent.

Although the state court did

not make findings on fraud, the plaintiffs relied on the state court record to prove their fraud charge here; they introduced no other evidence.

On the basis of the state court record, the Bankruptcy Judge found that the plaintiffs did not prove fraud because they failed to prove one element, namely reliance.

I recognize that the party seeking nondischarge of a bankruptcy debt has the burden of proof. U.S. Fidelity and Guaranty Co. v. Tanner, 279 F. Supp. 396, 400 (D. Colo. 1968). I also recognize that a Bankruptcy Judge's findings are entitled to great weight and should be overruled only when they are clearly

erroneous. In my view, however, considering the totality of the evidence, the Bankruptcy Judge clearly erred when he found that the plaintiffs, to whom Harris owed a fiduciary duty, did not rely on Harris's concealment of his \$102,500 fee and his receipt of the vendor's interest in the contract. Although it would have been preferable for the plaintiffs here to supplement the state court record with additional evidence on fraud, particularly reliance, a careful examination of the existing record requires the conclusion that Harris willfully and intentionally concealed material facts from his partners and that, if they had known the concealed facts, they would not have agreed to the terms of

the contract, and I so hold.

If any event, I do not believe if was necessary for the plaintiffs to prove actual reliance here because this is a case of concealment, not affirmative misrepresentation. It is only necessary to determine whether a reasonable man would attach importance to the concealed information in determining his course of action. An excellent statement of this principle is set forth in Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972), a securities case. There, the Supreme Court said that in a nondisclosure case

...positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the

making of this decision. . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact."

This rule was applied by the Second Circuit in Titan Group, Inc. v. Faggen, 513 F2d 234, 239 (1975):

. . .Unlike instances of affirmative misrepresentation where it can be demonstrated that the injured party relied upon affirmative statements, in instances of total non-disclosure, as in Affiliated Ute, it is of course impossible to demonstrate reliance, and resort must perforce be had to materiality, i.e., whether a reasonable man would attach importance to the alleged omissions in determining his course of action.

Under this reasonable man test, I do not think there is any question that the plaintiffs would have attached importance to Harris's \$102,500 commission and escrow fee and to Harris's acquisition of the

vendor's interest in their contract; these facts were certainly material. If the plaintiffs had known these facts, it is unlikely they would have permitted Harris to take such a large commission or to acquire the underlying title to their property.

## II. Section 17(a)(4)

In the alternative, the plaintiffs contend that Harris's debt to them is nondischargeable under Section 17(a)(4) of the Bankruptcy Act, 11 U.S.C. §35(a)(4), because it was created by Harris's "fraud, embezzlement, misappropriation or defalcation while acting . . . in any fiduciary capacity".

The Bankruptcy Judge held for Harris on the ground that when this

debt was created Harris was not acting in a "fiduciary capacity", as that term is used in Section 17(a)(4). I disagree.

The courts have attempted to avoid making Section 17(a)(4) so broad that it reaches such ordinary commercial relationships as creditor-debtor and principal-agent.<sup>7/</sup>

The purpose of the Bankruptcy Act, as stated in Hamby v. St. Paul Mercury Indemnity Co., 217 F.2d 78, 81 (1954), "is to grant a discharge of honest debts to honest debtors, not to grant discharges to those who have dishonestly misappropriated funds entrusted to them."

I hold that Harris while acting in a fiduciary capacity,

deliberately concealed the fact that he had collected for himself \$102,500 in violation of his obligation to his partners and that he also concealed the fact that he had acquired the vendor's interest in the contract in derogation of the rights of his partners.

This is not a case of a constructive trust or an innocent failure to divulge upon which the law imposes liability. This is a case of a flagrant violation of a fiduciary obligation. I therefore hold that Harris was acting in a fiduciary capacity under the Bankruptcy Act when his debt to the plaintiffs was created, and that, on the basis of my earlier finding of fraud, the debt is nondischargeable under Section

17(a)(4).

Because I have already held that the judgment debt is nondischargeable on two grounds, I need not decide whether the Bankruptcy Judge erred when he refused to permit the plaintiffs to assert nondischargeability under Section 17(a)(8) of the Bankruptcy Act.

The judgment of the Bankruptcy Court holding that the judgment debt owed by Harris to the plaintiffs was dischargeable in bankruptcy is reversed and the judgment debt is hereby declared to be nondischargeable.

Dated this 30th day of June, 1976.

United States  
District Judge

- 1/ International has hired to manage the apartments for five per cent of the gross rentals.
- 2/ Harris designed the documentation of the transaction to conceal the benefits he received. Christensen was not concerned with how Harris handled the documentation as long as it got \$907,500 from the sale.
- 3/ The balance of International's commission was to be paid out of overrides of the monthly mortgage payments.
- 4/ "Every partner must account to the partnership for any benefit and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property."
- 5/ Several other creditors filed complaints to exempt from discharge Harris's debts to them. American Express Co. contended that Harris's \$10,449 debt to it was for money obtained "under false pretenses and false representations in that [Harris] prepared and submitted to [American Express] fictitious charge slips with the intent to obtain money under false

pretenses." The parties settled that action by stipulating that \$7,000 of the debt was nondischargeable.

Eight other creditors contended that Harris owed them more than \$120,000, plus interest, because he induced them through fraud to buy certain real estate from him. The parties settled the action by stipulating that \$127,000 was nondischargeable.

- 6/ Section 17(a) provides:
 

"A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations . . . or for willful and malicious conversion of the property of another;... (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; ... or (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision."
- 7/ "If the act embrace such a debt [a factor retained the money of his principal], it will be difficult to limit its

application. It must include all debts arising from agencies; and indeed all cases where the law implies an obligation from the trust reposed in the debtor. Such a construction would have left but few debts on which the law could operate. In almost all the commercial transactions of the country, confidence is reposed in the punctuality and integrity of the debtor, and a violation of these is, in a commercial sense, a disregard of a trust. But this is not the relation spoke of in the first section of the act."

Chapman v. Forsyth et al., 43 U.S. 202, 207 (1844).

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

In the Matter of: )  
STANLEY G. HARRIS, )  
Bankrupt )

TOSHIO INHARA; ROBERT L. )  
KALEZ; LONGVIEW BOOMING )  
CO.; ROLAND BRUSCO; )  
ALBERT STARR; JAMES A. )  
WOOD; and GOLDEN KEY )  
ASSOCIATES, a partnership)

Plaintiffs-Appellees,) )  
vs. ) )

No.  
76-3307

STANLEY G. HARRIS, ) )  
Defendant-Appellant. ) )

TOSHIO INHARA; ROBERT L. )  
KALEZ; LONGVIEW BOOMING )  
CO.; ROLAND BRUSCO; )  
ALBERT STARR; JAMES A. )  
WOOD; and GOLDEN KEY )  
ASSOCIATES, a partnership)

Plaintiffs-Cross ) )  
Appellants, ) )

No.  
76-3307

vs. ) )  
STANLEY G. HARRIS, ) )  
Defendant-Cross )  
Appellee. ) )

OPINION

Appeal from the United States  
District Court for the  
District of Oregon

Before: MERRILL and TANG, Circuit  
Judges, and TAYLOR, District  
Judge.\*

PER CURIAM:

This is an appeal from the judgment of the district court holding that the state court judgment debt owing by appellant Harris to appellees was non-dischargeable under §17(a)(2) and (4) of the Bankruptcy Act.<sup>1/</sup> Appellant contends that his debt to appellees is dischargeable and that said sections are not applicable.

There is also a cross-appeal from the order of the district court denying a motion of appellees to amend the findings.<sup>2/</sup> The district court judgment was contrary to the ruling of

the bankruptcy court which held the debt dischargeable.

After a careful review of the record and the briefs of counsel, it is our opinion that the trial judge correctly concluded that the state court judgment debt owing by appellant to appellees was non-dischargeable under the fraud provisions of §17(a)(2) and 17(a)(4) for the reasons stated in his opinion. In Re Stanley G. Harris; Inhara, et al. v. Harris. F.Supp. \_\_\_\_\_ (D. Ore. \_\_\_\_\_).

Affirmed.

\* For the District of Idaho, sitting by designation.

1/ 17(a)(2) and (4) of the Bankruptcy Act is found at 11 U.S.C. §35(a)(2) and (4) and reads as follows:

(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . (2) are liabilities for obtaining money or property by false pretenses of false representations, or for wilful and malicious injuries to the person or property of another . . . (4) or were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; . . .

2/ The district court, in finding that appellees' state court judgment debt was non-dischargeable under 11 U.S.C., §35(a)(2), addresses only the fraud section, i.e., the "false pretenses or false representations" section. The district court did not rely upon or make any findings regarding the "wilful and malicious injuries" portion. The appellees' motion, requesting that the district court make findings in this regard, was denied.

IN THE UNITED STATES COURT  
OF APPEALS  
FOR THE NINTH CIRCUIT

TOSHIO INAHARA, ROBERT L. )  
KALEZ, LONGVIEW BOOMING )  
CO., ROLAND )  
BRUSCO, ALBERT STARR, )  
JAMES A. WOOD, and )  
GOLDEN KEY ASSOCIATES, )  
a partnership )  
Plaintiffs-Appellees, )  
vs. ) No. 76-3307  
STANLEY G. HARRIS, )  
Defendant-Appellant. )  
TOSHIO INAHARA, ROBERT L. )  
KALEZ, LONGVIEW BOOMING )  
CO., ROLAND BRUSCO, ALBERT )  
STARR, JAMES A. WOOD, and )  
GOLDEN KEY ASSOCIATES, a )  
partnership, )  
Plaintiffs-Cross )  
Appellants, )  
vs. ) No. 76-3346  
STANLEY G. HARRIS, )  
Defendant-Appellee. ) O R D E R

Before: MERRILL and TANG, Circuit  
Judges, and TAYLOR, District  
Judge

Motion for leave to file late  
petition for rehearing is granted in  
so far as it seeks panel rehearing and  
denied in so far as it seeks rehearing  
en banc.

Rehearing denied.

Supreme Court, U. S.

FILED

MAY 14 1979

MICHAEL RODAK, JR., CLERK

NO. 78-1582

IN THE SUPREME COURT  
OF THE UNITED STATES

STANLEY G. HARRIS, PETITIONER

v.

TOSHIO INAHARA, ROBERT L.  
KALEZ, LONGVIEW BOOMING CO.,  
ROLAND BRUSCO, ALBERT STARR,  
JAMES A. WOOD, and GOLDEN KEY  
ASSOCIATES, a partnership

BRIEF IN OPPOSITION TO PETITION

FOR A WRIT OF CERTIORARI

Herbert H. Anderson  
800 Pacific Building  
Portland, Oregon 97204

Counsel for Respondents

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NO. \_\_\_\_\_

IN THE SUPREME COURT  
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QUESTIONS PRESENTED

I

IS A JUDGMENT DEBT BASED UPON  
FRAUD, MISAPPROPRIATION OR DEFAL-  
CATION WHILE ACTING AS A FIDUCIARY  
UNDER OREGON LAW DISCHARGEABLE UNDER  
§17(a)(4) OF THE BANKRUPTCY ACT?

II

DOES THE RECORD SUPPORT THE  
FINDING OF THE DISTRICT JUDGE THAT "A

CAREFUL EXAMINATION OF THE EXISTING RECORD REQUIRES THE CONCLUSION THAT HARRIS WILLFULLY AND INTENTIONALLY CONCEALED MATERIAL FACTS FROM HIS PARTNERS AND THAT, IF THEY HAD KNOWN THE CONCEALED FACTS, THEY WOULD NOT HAVE AGREED TO THE TERMS OF THE CONTRACT" OR IN THE ALTERNATIVE, WHETHER IN A CASE OF NONDISCLOSURE, UNLIKE AFFIRMATIVE MISREPRESENTATION, AN INFERENCE OF RELIANCE ARISES IF THE CONCEALED FACTS ARE MATERIAL?

STATEMENT OF THE CASE

Petitioner Harris caused plaintiffs to form a partnership for the purpose of purchasing an apartment complex. As an inducement to plaintiffs, Harris joined the partnership and negotiated the purchase of the apartment complex as one

of the partners. Harris misrepresented to his partners that the purchase price was \$1,010,000 rather than the actual price paid the seller of \$907,500, failed to disclose that the seller was completely paid by the down payment, that Harris and his wholly-owned corporation were taking the sum of \$102,500 as a commission and that the seller's interest in the sale contract was being acquired by Harris without any expenditure on his part. The Circuit Court for Washington County and the Oregon Supreme Court, which affirmed the Circuit Court in Starr v. International Realty, 271 Or 396, 533 P2d 165 (1975), denied Harris the right to the secret commissions and the vendor's interest in the contract. The Circuit Court found that Harris was:

"\* \* \* duty bound to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction and that his failure to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction \* \* \* was fraudulent as to the other partners." Record on Appeal 25-26

Upon trial of the objection to Harris' discharge in bankruptcy, the parties submitted as evidence the entire record of proceedings before the Circuit Court for Washington County, including the testimony of 21 witnesses and 94 Exhibits and the opinion and orders of the Supreme Court of Oregon.

The bankruptcy judge held the judgment debt against Harris should be discharged.

The District Court reversed the determination of the bankruptcy judge

and held that the judgment debt of Harris should not be discharged. The Court of Appeals for the Ninth Circuit affirmed.

REASONS FOR DENYING THE PETITION

I

Petitioner does not contend that §17(a)(4) of the Bankruptcy Act is inapplicable to him because there was no fraud, embezzlement, misappropriation or defalcation by him. Defendant contends only that §17(a)(4) is inapplicable because his acts as a partner are not acts in "any fiduciary capacity" within the meaning of §17(a)(4). Whether a partner acts within a "fiduciary capacity" with respect to his partners depends upon applicable state law and the facts of the case.

The Oregon Supreme Court has held that a partner is in respect to his partners a "trustee and at the same time a cestui que trust." Fouchek et al. v. Janicek, 190 Or 251, 257, 225 P2d 783 (1950).

None of the cases cited by petitioner, except In Re Frazzetta<sup>1/</sup> 1 F. Supp. 122 (W.D.N.Y. 1932), arose in states which at the time of decision had adopted the Uniform Partnership Act under which there is a statutory duty to act as a fiduciary in regard to any transaction connected with the partnership.

Under applicable Oregon Law, ORS 83.340, the following statutory provisions necessarily become part of every partnership agreement:

"Partner accountable as a fiduciary \* \* \*.

(1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct or liquidation of the partnership or from any use by him of its property."

In Oregon the fiduciary relation created by statute exists from the inception of the partnership. In the case between these same parties in the state court the Oregon Supreme Court emphasized the fiduciary nature of the partnership relation under Oregon law:

"When, as in this case a real estate broker undertakes to join as a member of a partnership or joint venture in the purchase of real property on which he holds a listing, he is also subject to the fiduciary duties of undivided loyalty and complete disclosure owed by the partner to another.

Indeed, one of the fundamental duties of any partner who deals on his own account in matters within the scope of his fiduciary relationship is the affirmative duty to make a full disclosure to his partners not only of the fact that he is dealing on his own account, but all of the facts which are material to the transaction."

Starr et al. v. International

Realty, Ltd. et al., 271 Or 396, 403, 533 P2d 165, 168 (1975).

Davis v. Aetna Acceptance Co., 293

US 328 (1934), cited by petitioner, has no application. There the court merely held:

"\* \* \* A mortgagor in possession before condition broken is not a trustee for the mortgagee within the meaning of this statute, though he has charged himself with a duty to keep the security intact. \* \* \*" 293 US at 334

In Davis the court referred to Chapman v. Forsyth, 2 How. 202, 11 L.Ed. 236 (1844) which held that under

the 1841 Act of Bankruptcy a factor does not act in a fiduciary capacity to his customer. Subsequent cases have followed the rule that trust imposed in a debtor in a commercial sense does not create the type of fiduciary relation required under Section 17(a)(4) of the Bankruptcy Act. Those cases have no application here, nor do partnership cases decided under laws different from those of Oregon.<sup>2/</sup>

Both the Oregon Supreme Court and the District Court in this case held that under Oregon law, Harris was in a fiduciary relation to his partners. The District Court held expressly that it was the kind of fiduciary capacity meant by Section 17(a)(4) of the Bankruptcy Act. The District Court said:

"\* \* \* This is a case of flagrant violation of a fiduciary obligation. I therefore

hold that Harris was acting in a fiduciary capacity under the Bankruptcy Act when his debt to the plaintiffs was created \* \* \*. In Re Harris, 458 F. Supp. 238, 243 (D. Or. 1976).

II

There is no question in this case that Harris did obtain money by false pretenses and false representations. The trial judge in the state court action said "that his failure to make a full and complete disclosure of profits that he would either directly or indirectly receive from the transaction \* \* \* was fraudulent as to the other partners." ROA 25-26

The District Court found that:

"\* \* \* a careful examination of the existing record requires the conclusion that Harris willfully and intentionally concealed material facts from his partners and that, if they had known the concealed

facts, they would not have agreed to the terms of the contract, and I so hold". In Re Harris, 458 F. Supp. at 242

Petitioner misconstrues the holding of the District Court and says that the District Court would "amend the Bankruptcy to dispense with the requirement of the proof of reliance." Contrary to petitioner's statement the District Court did not dispense with proof of reliance but expressly found by "a careful examination of the existing record" that there was reliance.

The District Court did go on, after its finding of reliance, to point out that, "in any event" this court has said:

"Under the circumstances of this case, involving primarily

a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of the decision \* \* \*. Affiliated Ute Citizens v. United States 406 US 128, 153 154 (1972)

The District Court also referred to the decision of the Second Circuit where the court said:

"\* \* \* Unlike instances of affirmative misrepresentation where it can be demonstrated that the injured party relied upon affirmative statements, in instances of total non-disclosure, as in Affiliated Ute, it is of course impossible to demonstrate reliance, and resort must therefore be had to materiality, i.e., whether a reasonable man would attach importance to the alleged omissions in determining his course of action.

"In cases involving non-disclosure of material facts, even when coupled with access to the information, materiality rather than reliance thus becomes the decisive element of causation. \* \* \* And determination of materiality allows

logically an inference of reliance. \* \* \* Tetan Group, Inc. v. Faggen, 513 F2d 234, 239 (Cal 1975).

### III

The Petition herein presents none of the special and important reasons for certiorari described in Supreme Court Rule 19.

There is no conflict with a decision of another court of appeals. There are in fact no decisions by any other court of appeals on the question of whether a partner made a fiduciary by state statute is acting in the fiduciary capacity mentioned in Section 17(a)(4) of the Bankruptcy Act. Nor is there any conflict in the circuits on the question of the method of showing reliance in case of false pretenses or false representation by nondisclosure. This

Court and the Second Circuit, as well as the Ninth Circuit in this case, have held that in a case of nondisclosures, the question becomes one of materiality and, as this court said, whether "a reasonable investor might have considered them important in the making of the decision." Affiliated Ute Citizens v. United States, 406 US at 153.

There has been no claim that an important state question has been decided in conflict with applicable state law. Nor has there been any assertion that there has been an important question of federal law which has not been, but should be decided by this court.

The issue concerning reliance in a case of nondisclosure, has been decided by this court. The issue concerning

whether a partner made a fiduciary by the state law is acting in the "fiduciary capacity" of Section 17(a)(4) of the Bankruptcy Act is not of the magnitude of importance requiring this court's attention. In the 81 years since the Bankruptcy Act of 1898 was enacted no other case on that point has reached a court of appeals and there has been only one other reported district court case which discusses the point.

On October 1, 1979 the Bankruptcy Reform Act of 1978, Pub. L. 95-598, will become effective. Under the new law exceptions to discharge are covered in Section 523. The language of both the present Section 17(a)(2) and Section 17(a)(4) have been expanded to include additional grounds for exception to

discharge. In addition to "false pretenses" and "false representation" Section 523(a)(2)(A) includes "or actual fraud." Section 523(a)(4) excepts a debt for "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" rather than "fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity" as now stated in Section 17(a)(4).

There appear no "special and important reasons" for review of an exception from a discharge in bankruptcy of a debt by a partner who has defrauded his partners by secretly appropriating to his use substantial property which two state courts and two federal courts have held to be partnership property.

CONCLUSION

The petitioner presents none of the requirements for granting the writ. The case was decided below based upon Oregon law applied to the particular facts of the case, and upon a federal statute now repealed. The case raises no issues important beyond the instant matter. Certiorari should be denied.

DATED: May 11, 1979.

Respectfully submitted,

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Herbert H. Anderson  
Attorney for Respondents

FOOTNOTES

1/ In Re Frazzetta the Court denied a discharge to a partner who failed to account for money collected on behalf of the partnership. The discharge was denied apparently because Frazzetta "deliberately set out to defraud his partners" although the court refers to cases denying discharge for "willful and malicious" injury to property. The statement that a partner is not "within the definition of 'fiduciary capacity' as is contemplated by Section 17 of the Bankruptcy Act" is dictum and is contradicted by the next sentence which states that under New York law "a partner owes a fiduciary obligation to his partners". The obscure dictum of that case confuses rather than enlightens.

2/ Section 1 of the Act of August 19, 1841, 5 Stat. 440, prevented discharge of debts "created in consequence of a defalcation as a public officer; or as executor, administrator, guardian or trustee or while acting in any other fiduciary capacity." By application of the ejusdem generis rule "other fiduciary capacity" was held to "mean the same class of trusts" as those enumerated, "not cases of implied, but special trusts." Chapman v. Forsyth, 2 How 202, 208 L.Ed. 236 (1844). But the present statute

excepts from discharge debts "created by his fraud, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." Now the statute refers only to "officer" and there is no "class" of officers so "in any fiduciary capacity" in the present statute is not limited to a "class" consisting of public officer, executor, administrator, guardian or trustee. Prior to the adoption of the Uniform Partnership Act, which expressly makes a partner a fiduciary, it could be argued that the fiduciary duties of a partner implied at common law were not of the class of "special trusts" enumerated in the 1841 Act. No case has discussed the differences between the language of the 1841 Act and the 1898 Act in this regard, but it appears likely that a court faced with this issue would decide that "any fiduciary capacity" in the present statute is broader than "any other fiduciary capacity" in the 1841 Act and would include the implied fiduciary obligation of a partner at common law.